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Earmarking of public revenues in Montana

Gilbert R. Dyer

The University of Montana

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EARMARKING OF PUBLIC REVENUES IN MONTANA

by

GILBERT R. DYER

B.A., Montana State University, 1957

Presented in partial fulfillment of the requirements for the degree of Master of Arts

MONTANA STATE UNIVERSITY

1958

Approved by:

Chairman, Board of Examiners

Dean, Graduate School

AUG 20 1958

Date
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INTRODUCTION

The payment of taxes has become a virtually unavoidable part of modern living. Few in present-day America deny that taxation is a necessary device in maintaining our way of life. Governmental services have continually grown in importance in our economy and show little sign of decreasing in magnitude in the foreseeable future. Ever-growing demands upon governmental agencies increase the need of these agencies for revenues. The problem of obtaining sufficient revenues to match expenditures demanded by the populace is becoming acute in many areas, particularly on the state and local level.

By 1965 expenditures on the federal level can be expected to change but little in absolute amount, assuming that a high level of business activity is maintained, price levels remain stable, and wars can be avoided. Expenditures on the state and local level, however, may increase by as much as two-thirds of the 1953 outlay.¹ There is no indication that state and local revenues will increase as much as expenditures.

The Census Bureau, projecting from 1953 to 1965, expects the total United States population to increase by 19

percent, basing their estimate on the 1950-53 fertility rates. Breaking the projection down to age groups, the group between the ages of 5 and 19 is expected to increase by 40.9 percent, the group over 65 by 30.1 percent, and the group between 20 and 64 by only 9.9 percent. The age group between 25 and 44 is expected to decline .6 percent because of the low birth rate in the depressed 1930's.

A population increase of this type lends itself to inflation. Demand is likely to become more inelastic, so that quantities produced will not react to price changes in the future to the extent experienced at present. State and local expenditures for education, highways, and public welfare, can be expected to increase markedly. Experts anticipate a college enrollment of some 4 million students in 1965, an increase of some 75 percent over the 1953 level. All in all, if the present trend continues, state and local revenues may increase by about 50 percent while anticipated expenditures would increase by as much as 90 percent.

Considering these factors, there is little question that state and local governments face an acute tax problem in the next few years.

An accompanying problem is the overall equalization of the state and local tax burden. Though agreement can be obtained on the necessity of taxation per se, who should pay

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\(^{2}\)Ibid.\(^{3}\)Ibid.
and in what amount is another problem, and one on which agreement is far more difficult, if not impossible, to achieve. The tax system, in general, should be one that interferes as little as possible with economic growth.\textsuperscript{4} Where this nebulous balance lies at any given time cannot be accurately predicted. Tax sources are many and varied. Some predominant sources of state revenue include an income tax, utilized by 31 states, a sales tax, utilized by 31 states, taxes on banks and financial institutions, levied in 32 states, taxes on tobacco products, levied by 41 states, death taxes, levied by 42 states, etc.\textsuperscript{5} All states tax insurance companies, employ highway-user taxes, and license corporations. Local governmental units are financed predominantly by property taxes.

From the above it is apparent that state and local governments must either broaden their tax bases, i.e., find new revenue sources, or raise tax rates on present sources.

There is a third factor involved in taxation, however. Why revenues are required and the sources from which they are obtained represent only part of the picture. Disburse-


ment of collected revenues must necessarily be considered. This thesis, then, will deal with disbursement, specifically with the earmarking of public revenues, with special attention being given to the State of Montana. An attempt will be made to disprove the hypothesis that earmarking of public revenues is in accordance with good tax policy.
CHAPTER I

THE BACKGROUND AND SCOPE OF REVENUE EARMARKING

The term "earmarked revenue" refers to money collected for one or more prescribed uses. In the terminology of government accounting, such a revenue, collected from a specified tax source, becomes a "fund," to be devoted to a legally defined special purpose. The term "general fund" applies to all receipts and expenditures not earmarked.¹

I. GENERAL BACKGROUND

Actual earmarking of revenues originated on the local government level with the device of special assessments.² Assessments were levied for the purpose of financing some permanent improvement such as street paving or sidewalks, and a fund thus was created for the special purpose in mind. The theory underlying this approach is characteristically referred to as the benefit principle: that payment should be made in direct relationship to benefit received.

Within the several states, some earmarking of reve-


nues is a result of the state constitutions. Most, however, is born of legislative decree.

State governments were besiegged during the depression of the 1930's by demands for relief from heavy local property taxes. They turned to new tax sources in order to finance local aid programs. With more and more taxing power falling to the state governments and increased reliance of local governments on state aid, earmarked taxes became firmly entrenched as a fiscal device. In that the taxes were originally collected by the state to relieve the municipality, funds obtained from specific sources were frequently allocated to a local unit, either for general use or for a specified purpose. In the latter case, it could be said that funds were twice-earmarked: the municipality as well as the state was obligated to disburse such revenue for a particular function.

The federal government has contributed indirectly and directly to state acceptance of earmarking as a fiscal device.

As early as 1916, Congress had provided $75 million for use over a five-year period to improve rural post roads. The law required participating states to match the funds

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\[3\] Ibid.
offered at the federal level. Subsequent road and highway allocations carried similar stipulations. It seems possible that during the depression the states hit upon earmarking of highway-user taxes to assure that they would be in a position to receive at least some federal contributions despite possible adverse future fluctuations of general fund receipts.

The introduction of the national Social Security program in the 1930's required that a tax be levied and the proceeds be earmarked on the state level.

In 1937 federal funds were made available to the states for wildlife restoration projects. The legislation stipulated that recipient states must pass laws for the "conservation of wildlife" which included "a prohibition against the diversion of license fees paid by hunters for any other purpose than the administration of State fish and game department[s] . . ." In 1950 similar federal aid legislation was passed regarding "fish restoration and management projects." Again, federal funds were made available under

---


2 In this thesis, Social Security contributions will not be considered in reference to earmarking unless specifically mentioned.

the act only to those states which passed laws incorporating
the proviso that there be "a prohibition against the diver­
sion of license fees paid by fishermen for any other purpose
than State fish and game department[s] . . . ."7

II. BACKGROUND IN MONTANA

The Montana constitution makes no reference to ear­
marking of tax revenues; all such earmarking in the state is
a result of legislative action.

Article XXI of the constitution, however, provides
that gifts to the state amounting to $250 or more may, at
the discretion of the donor, be placed in the state Trust
and Legacy Fund. The Trust and Legacy Fund is a type of
holding fund incorporating the following sub-funds: a state
permanent fund; a permanent school fund; a permanent revenue
fund for the University of Montana; and a fund for the bene­
fit of scientific, educational, benevolent and charitable
organizations. A giver, if he chooses to donate to the
Trust and Legacy Fund, can stipulate to which of these sub­
funds his donation is to contribute. The earnings of these
permanent funds are strictly earmarked for their correspond­
ing activities.

7 Public Law 681, 64 Stat. 430, 81st Cong., 2d Sess.,
Chap. 658.
Cigarette Tax

In 1947, cigarettes were taxed 2 cents per package of twenty with the proceeds directed to the general fund. On December 7, 1950, Initiative No. 54 provided that an additional 2 cents per package be levied and earmarked for the purpose of paying bonuses to veterans of World War II. The legislature further increased the cigarette tax in 1957, earmarking 1 cent for a Korean veterans' bonus, maintaining the 2 cents earmarked for World War II veterans, and increasing the contribution to the general fund from 2 cents to 5 cents. As of this writing, 37.5 percent of the revenue realized from state cigarette taxes is earmarked. Though the earmarked percentage of total revenue realized from this source has decreased from 50 percent in 1956 to the present 37.5 percent, the absolute amount has increased considerably. Between 1954 and 1957, receipts from the cigarette tax increased by $339,000. (See Table IV, page 22.)

Liquor License Tax

Before July 1, 1941, the liquor license tax was apportioned so that 50 percent of the revenue was earmarked to the state public school fund and the remaining 50 percent to the public welfare fund to be devoted to administration

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8 Revised Codes of Montana, 1947, 84-5621.
9 Laws of Montana, Thirty-Fifth Session, 1957, Chap. 18, Sec. 3; Chap. 44, Sec. 7.
of Social Security laws.  

Under the present law the tax on alcoholic beverages other than beer is 8 percent. All proceeds go to the general fund. An additional 4 percent is collected by the state and distributed on a population basis to counties and cities. The county-city recipients are not required to use this income for any particular purpose.

Personal Income Tax

Montana began taxing personal income in 1933. The first law provided that 55 percent of the income tax receipts were to go to the general fund. The remainder was earmarked: 20 percent to the common school interest and income fund, 20 percent to the school equalization fund, and 5 percent to a relief fund. The law was rewritten in 1937, allocating 50 percent of personal income tax receipts to the general fund, 25 percent to the school interest and income fund, and 25 percent to the school equalization fund. In 1941 the law was again changed to give 75 percent of the income tax revenues to the general fund and to earmark 25 percent for the school equalization fund.

10 Laws of Montana, Twenty-Fifth Session, 1937, Chap. 84, Sec. 29; Laws of Montana, Twenty-Seventh Session, 1941, Chap. 14, Sec. 1.

11 Revised Codes of Montana, 1947, 84-1901; Revised Codes of Montana, 1933, 2295.28; Laws of Montana, Twenty-Fourth Session, 1935, Chap. 109, Sec. 28. Constitutional Amendment XII was required to instigate the original income tax.
Corporation Income Tax

Prior to 1933, all revenues from corporation income tax went to the general fund. Legislation in 1933 earmarked 25 percent of these receipts to the school equalization fund, leaving 75 percent for the general fund.\(^\text{12}\)

Tax Receipts from Public Utilities

Before 1941, half of the revenues from the taxation of public utilities was earmarked. Of the receipts from this source, 50 percent contributed to the general fund, 25 percent was earmarked to the school interest and income fund, and 25 percent to the school equalization fund. Some exceptions existed. For example, 25 percent of state receipts from the taxation of natural gas distributing companies was earmarked for a welfare fund to implement Social Security laws. Since 1941, all revenues from the taxation of public utilities have gone to the general fund.\(^\text{13}\)

Metal Mines Tax

Fifty percent of the metal mines tax was also earmarked prior to 1941. Before that year, 50 percent of these revenues went to the general fund and 50 percent to the school interest and income fund.\(^\text{14}\) Legislation now provides

\(^\text{12}\)\textit{Laws of Montana, Twenty-Third Session, 1933}, Chap. 166, Sec. 16.

\(^\text{13}\)\textit{Laws of Montana, Twenty-Seventh Session, 1941}, Chap. 14, Sec. 1.

that all proceeds go to the general fund.

Gasoline License Tax

In 1921 Montana placed a 1 cent per gallon license tax on the sale of gasoline within the state. Two-thirds of the revenue went to the general fund. The remaining third was allocated to county school funds on the basis of the number of teaching positions. This tax was increased to 2 cents per gallon in 1923, and the distribution was changed to 40 percent to the general fund, 20 percent to the highway fund, and 40 percent to county road funds.

In 1924 the State Board of Equalization recommended that "as the revenue received from the gasoline license tax is primarily a road tax, all money derived from this source should be applied to the construction and maintenance of highways . . . ."\textsuperscript{15} The Supreme Court in that same year found the gasoline license tax to be discriminatory and unconstitutional.\textsuperscript{16} However, the decision did not hold for very long, and in 1927 a gasoline license tax of 3 cents became


law. After refunds, all revenues from this tax since that time have been earmarked to the highway fund. Twenty-five percent of the gasoline tax is retained as a drawback fund. Any of the drawback fund remaining at the end of a fiscal year reverts to the highway fund. The tax was increased to 5 cents in 1929, 6 cents in 1949, 7 cents in 1955, and reverted back to 6 cents in 1958.

Session Laws of Montana, 1955, provided that a gasoline tax of 1 cent was to be earmarked to pay the principal and interest on debentures issued by the State Highway Department. The time period designated was from April 1, 1955, to March 31, 1957. No provision was made to maintain the additional tax in 1958, accounting for the fact that the tax was reduced 1 cent per gallon in that year.

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17 Laws of Montana, Nineteenth Session, 1925, Chap. 186, was held to be constitutional, but was superseded by Initiative Measure No. 31; Laws of Montana, Twentieth Session, 1927, p. 604. Gasoline imported to be sold within the state is also subject to the tax.

18 Considerable question exists as to whether refunding gasoline tax money to farmers is constitutional. A license tax is charged for the privilege of doing business in the state. The Montana gasoline tax is a license tax and, even though farmers do not use the fuel on the roads, the dealer's privilege of doing business is in no way affected.

19 Laws of Montana, Twentieth Session, 1927, Chap. 19, Sec. 13, does not make allowance for a drawback fund. Laws of Montana, Twenty-First Session, 1929, Chap. 178, Sec. 13, sets up the drawback fund.

Property Tax

Soon after World War I, an attempt was made to finance a bonus payment to Montana veterans by means of an earmarked 1-mill property tax. The Montana Supreme Court ruled that such a tax was contrary to the state constitution, Article XIII, Section 11, which specifies that taxes are to be collected for public purposes only. The court felt that "public purposes" was synonymous with "governmental purposes" and that a tax levied for payment of a veterans' bonus did not involve a public purpose but was intended as a gift.\(^{21}\) A constitutional provision submitted to the people November 4, 1924, was defeated by a majority of 1569,\(^{22}\) thus defeating the first attempt in Montana to earmark a major tax source.\(^{23}\)

By act of the 1939 legislative session, confirmed by popular vote in 1940, a 3\(\frac{1}{2}\)-mill property tax was earmarked for the Montana University System, to become effective in 1941.\(^{24}\) In 1947 the legislature passed, and in 1948 the


\(^{22}\)Montana State Board of Equalization, First Biennial Report, op. cit.

\(^{23}\)The Supreme Court's action regarding Initiative No. 54, and the recent ruling on the Korean bonus bill, indicates a change in attitude.

\(^{24}\)Laws of Montana, Twenty-Sixth Session, 1939, Chap. 143, Sec. 1.
voters approved, a provision raising the university levy to 6 mills for a period of ten years.\(^{25}\) Six mills will be requested and again voted upon in 1958.

A 2-mill levy still contributes to the general fund at the discretion of the State Board of Equalization. The Board is obligated to levy taxes sufficient to raise the specific amount of the revenue required by the legislative assembly for state purposes.\(^{26}\)

**Inheritance Tax**

The Revised Codes of Montana, 1935, provided that inheritance tax receipts prior to March 1, 1937, be earmarked as follows: 15 percent to the school interest and income fund; 15 percent to the school equalization fund; 70 percent to a conservation fund, until the tax had contributed a total of $350,000, after which the 70 percent would contribute to the relief fund until payments to that category amounted to $250,000; the 70 percent then reverted to the general fund.\(^{27}\) As of March 1, 1937, 50 percent of all inheritance tax income was to go to the general fund. The remaining 50 percent was to be distributed to county school


\(^{26}\) Revised Codes of Montana, 1947, 84-713; Laws of Montana, Eighteenth Session, 1923, Chap. 3, Sec. 13.

\(^{27}\) Revised Codes of Montana, 1935, 10400.49.
systems on the basis of the number of teaching positions in each.  

Since 1941 all inheritance tax receipts have gone to the general fund.  

III. THE SCOPE OF EARMARKING

Funds are characteristically earmarked for such purposes as education, highway maintenance and construction, veterans' bonuses, welfare, etc. In 1954 every state in the Union with the exception of Delaware earmarked at least some revenues and, in that year, 24 states earmarked over 50 percent of their total tax revenues. The all-state average of total earmarked collections was 51.3 percent, with individual totals ranging from a high of 89 percent in Alabama to a low of 6.1 percent in Rhode Island. Table I, page 19, shows the extent, by function, to which earmarking has been utilized among the states.

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28 Ibid., 10400.44.
29 Laws of Montana, Twenty-Seventh Session, 1941, Chap. 14, Sec. 1.
31 Ibid., pp. 12-14.
IV. EARMARKING IN MONTANA

Major Taxes

In 1954 Montana earmarked 61.4 percent of total tax receipts. In other words, of the total per capita tax of $64.09, $39.35 was contributed to earmarked funds. Table II, page 20, indicates disposition of major tax revenues in Montana for fiscal year 1954. Collections amounted to slightly more than $39 million; a little over $24 million was earmarked.

Only 14 states earmarked a greater percentage of total tax receipts in 1954 than did Montana.

Table III, page 21, gives state figures for fiscal 1957. Though the percentage of total revenue earmarked has fallen slightly, in absolute amount it has increased by over $6 million. This arises from the fact that though all tax revenues have gone up, some of those not earmarked have risen more rapidly than those earmarked. Table IV, page 22, shows the difference in tax revenue by source between fiscal years 1954 and 1957.

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32 Ibid., p. 47.

Other Earmarked Funds

Aside from the major taxes earmarked in Montana, several occupational fees revert, or are earmarked, to the state examining boards of the occupation in question. Table V, page 23, lists these occupations and the revenues collected in fiscal 1957.

The Montana Livestock Commission fund in 1957 received 3 mills on the taxable value of sheep and 2 mills on the taxable value of all other livestock. From this mill levy the Livestock Commission collected $120,000. Another $232,000 was received in fees charged for various services.

There is also an earmarked tax for the Montana Bounty fund. In fiscal 1957 the bounty fund received 4 1/2 mills on the taxable value of sheep and 1 mill on the taxable value of all other livestock, a total in collections of $85,000.

The Montana Livestock Sanitary Board collects 3 mills on all livestock, and in 1957 took in $169,000. Another $44,000 was earmarked to the Sanitary Board Meat Inspectors.

The Montana Fish and Game Department received, from the sale of hunting and fishing licenses and beaver and shipping permits, $1,678,000 in 1957.

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Figures in this section were obtained by personal interviews of members of the Montana State Board of Equalization.
<table>
<thead>
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<th>Function</th>
<th>Number of States Earmarking&lt;sup&gt;b&lt;/sup&gt;</th>
</tr>
</thead>
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<tr>
<td>Education</td>
<td>28</td>
</tr>
<tr>
<td>Welfare</td>
<td>15</td>
</tr>
<tr>
<td>Highways</td>
<td>12&lt;sup&gt;c&lt;/sup&gt;</td>
</tr>
<tr>
<td>Veterans' Bonuses and Services</td>
<td>14</td>
</tr>
<tr>
<td>State and Local Fairs</td>
<td>6</td>
</tr>
<tr>
<td>Conservation</td>
<td>9</td>
</tr>
<tr>
<td>Local General Purposes</td>
<td>28</td>
</tr>
<tr>
<td>Debt Service</td>
<td>10</td>
</tr>
<tr>
<td>Homestead Exemptions</td>
<td>1</td>
</tr>
<tr>
<td>Confederate Pensions</td>
<td>3&lt;sup&gt;d&lt;/sup&gt;</td>
</tr>
<tr>
<td>Other</td>
<td>24&lt;sup&gt;d&lt;/sup&gt;</td>
</tr>
</tbody>
</table>


<sup>b</sup>Represents the number of states dedicating, in whole or in part, one or more taxes for the function or purpose shown.

<sup>c</sup>Taxes other than highway-user.

<sup>d</sup>Chiefly firemen's pensions.
## TABLE IIa

MAJOR TAX REVENUES IN MONTANA

Fiscal Year 1954

<table>
<thead>
<tr>
<th>State Tax</th>
<th>Collections (Thousands)</th>
<th>To General Fund</th>
<th>Earmarked</th>
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<tbody>
<tr>
<td>Sales or Gross Receipts</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>2,791</td>
<td>50%</td>
<td>50% veterans' bonus</td>
</tr>
<tr>
<td>Alcoholic Beverages</td>
<td>1,759</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Insurance Company</td>
<td>1,311</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Public Utility</td>
<td>784</td>
<td>100%</td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual</td>
<td>4,923</td>
<td>75%</td>
<td>25% education</td>
</tr>
<tr>
<td>Corporation</td>
<td>1,812</td>
<td>75%</td>
<td>25% education</td>
</tr>
<tr>
<td>Highway-User</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gasoline</td>
<td>13,326</td>
<td>100%</td>
<td>highways</td>
</tr>
<tr>
<td>Registration</td>
<td>2,379</td>
<td>100%</td>
<td>highways</td>
</tr>
<tr>
<td>Operators' licenses</td>
<td>275</td>
<td>95%</td>
<td>5% state police retirement</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>4,237</td>
<td></td>
<td>93.3% state university</td>
</tr>
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<td></td>
<td></td>
<td></td>
<td>6.7% state hospital bond debt service</td>
</tr>
<tr>
<td>Severance</td>
<td>1,418</td>
<td>100%</td>
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<tr>
<td>Corporation</td>
<td></td>
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</tr>
<tr>
<td>Licenses</td>
<td>73</td>
<td>100%</td>
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</tr>
<tr>
<td>Death and Gift</td>
<td>1,141</td>
<td>100%</td>
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</tr>
<tr>
<td>Miscellaneous</td>
<td>3,122</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>39,351</td>
<td>38.6%</td>
<td>61.4%</td>
</tr>
</tbody>
</table>


b*After deduction of amount allocated to local firemen’s relief.*

c*Increased to 15% by 1955 legislation.*
TABLE III\textsuperscript{a}

MAJOR TAX REVENUES IN MONTANA

Fiscal Year 1957

<table>
<thead>
<tr>
<th>State Tax</th>
<th>Collections (Thousands)</th>
<th>Disposition</th>
<th>To General Fund</th>
<th>Earmarked</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales or Gross Receipts</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>$3,134</td>
<td>50%</td>
<td>50% veterans' bonus</td>
<td></td>
</tr>
<tr>
<td>Alcoholic Bever.</td>
<td>2,961</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance Company</td>
<td>1,544</td>
<td>100%\textsuperscript{b}</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Utility</td>
<td>913</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual</td>
<td>7,550</td>
<td>75%</td>
<td>25% education</td>
<td></td>
</tr>
<tr>
<td>Corporation</td>
<td>2,360</td>
<td>75%</td>
<td>25% education</td>
<td></td>
</tr>
<tr>
<td>Highway-User</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gasoline, Diesel Registration\textsuperscript{d}</td>
<td>17,667</td>
<td>100% highways</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operators' Licenses</td>
<td>2,829</td>
<td>100% highways</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Operators' Licenses</td>
<td>550</td>
<td>85%</td>
<td>15% state police retirement</td>
<td></td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>4,573\textsuperscript{c}</td>
<td>93.3% state university</td>
<td>6.7% state hospital bond debt service</td>
<td></td>
</tr>
<tr>
<td>Severance</td>
<td>3,472</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corp. Licenses</td>
<td>89</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Death and Gift</td>
<td>1,323</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>2,725</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>$51,690</td>
<td>43.6%</td>
<td>56.4%</td>
<td></td>
</tr>
</tbody>
</table>

\textsuperscript{a}Figures obtained in personal interviews with members of the State Board of Equalization. Total collections figure shown is an estimate.

\textsuperscript{b}After deduction of amount allocated to local firemen's relief.

\textsuperscript{c}Includes university millage of $3,943, training school $315, and insane hospital $315.

\textsuperscript{d}Registration includes motor vehicle recording, new car tax and gross vehicle weight tax.
# TABLE IV

## MAJOR TAX REVENUES IN MONTANA

Comparison of Fiscal Years 1954 and 1957

<table>
<thead>
<tr>
<th>State Tax</th>
<th>Collections (Thousands)</th>
<th>Total Earmarked</th>
<th>Change Earmarked</th>
<th>Change Not Earmarked</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1954</td>
<td>1957</td>
<td>1954</td>
<td>1957</td>
</tr>
<tr>
<td>Sales or Gross</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tobacco</td>
<td>$ 2,791</td>
<td>$ 3,130</td>
<td>1,395</td>
<td>1,565</td>
</tr>
<tr>
<td>Alcoholic</td>
<td>1,759</td>
<td>2,961</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beverages</td>
<td>1,311</td>
<td>1,544</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Insurance Company</td>
<td>784</td>
<td>913</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Public Utility</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Individual</td>
<td>4,923</td>
<td>7,550</td>
<td>1,230.75</td>
<td>1,887</td>
</tr>
<tr>
<td>Corporation</td>
<td>1,812</td>
<td>2,360</td>
<td>453</td>
<td>590</td>
</tr>
<tr>
<td>Highway-User</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Gasoline Registration</td>
<td>13,326</td>
<td>17,667</td>
<td>13,326</td>
<td>17,667</td>
</tr>
<tr>
<td>Operators' Licenses</td>
<td>2,379</td>
<td>2,829</td>
<td>2,379</td>
<td>2,829</td>
</tr>
<tr>
<td>Other</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td>4,237</td>
<td>4,573</td>
<td>4,237</td>
<td>4,573</td>
</tr>
<tr>
<td>Severance</td>
<td>1,418</td>
<td>3,472</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Corporation License</td>
<td>73</td>
<td>89</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Death &amp; Gift</td>
<td>1,111</td>
<td>1,323</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>3,122</td>
<td>2,725</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>$39,351</td>
<td>$51,690</td>
<td>23,035</td>
<td>29,193.5</td>
</tr>
</tbody>
</table>

Tax Foundation, Inc., *Earmarked State Taxes*, op. cit., p. 47, supplies 1954 figures. Figures for 1957 were obtained in personal interviews with members of the Montana State Board of Equalization.
<table>
<thead>
<tr>
<th>Occupation</th>
<th>Fees</th>
</tr>
</thead>
<tbody>
<tr>
<td>Abstractors</td>
<td>$1,000</td>
</tr>
<tr>
<td>Architectural</td>
<td>2,000</td>
</tr>
<tr>
<td>Attorneys</td>
<td>6,000</td>
</tr>
<tr>
<td>Barbers</td>
<td>4,000</td>
</tr>
<tr>
<td>Beauty Operators</td>
<td>10,000</td>
</tr>
<tr>
<td>Certified Public Accountants</td>
<td>2,000</td>
</tr>
<tr>
<td>Chiropractors</td>
<td>2,000</td>
</tr>
<tr>
<td>Dentists</td>
<td>2,000</td>
</tr>
<tr>
<td>Embalmers</td>
<td>2,000</td>
</tr>
<tr>
<td>Engineers</td>
<td>4,000</td>
</tr>
<tr>
<td>Medical</td>
<td>7,000</td>
</tr>
<tr>
<td>Nurses</td>
<td>5,000</td>
</tr>
<tr>
<td>Pharmacists</td>
<td>12,000</td>
</tr>
<tr>
<td>Plumbers</td>
<td>11,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>$70,000</td>
</tr>
</tbody>
</table>

*Figures obtained in personal interviews with members of the State Board of Equalization.*
CHAPTER II

THE CASE FOR EARMARKING

I. POLITICAL CONSIDERATIONS

As has been mentioned, state governments face an ever-increasing need for additional revenue, a need which shows every indication of becoming even more acute in the future. And legislators on the state level are more often than not faced with a disinterested citizenry. Whereas special interest groups press for more services and revenues, the unorganized citizenry usually takes but a cursory interest in state activities. Whatever the cause for this lack of interest, it places a legislature attempting to levy taxes in a difficult position.

Taxes may be levied by decree of the state constitution, by legislative action, by initiative and by referendum. Of these methods, the popularity of a proposed program to which a tax revenue might be earmarked is possibly important

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1 The primary concern of this thesis is with economic characteristics of earmarking, not political ramifications. The political considerations mentioned are by no means exhaustive.


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in the second and definitely important in the third and fourth. If a law is so expressed as to guarantee spending the proposed tax revenue for an appealing purpose, the chances of popular acceptance of an additional tax burden may be increased.

In the case of many taxes, any increase must carry formal public approval.³ The Montana constitution, for example, demands that a state property tax in excess of 2 mills per dollar of taxable property be voted on at the polls.⁴ Legislatures have found that one of the best methods to minimize voter complaint and at the same time secure needed monies is to earmark the proposed increase for some popular purpose.⁵ Because the need for revenue from an increased tax is questioned only infrequently, it would appear that earmarking in such instances constitutes expedient political practice.

On the other hand there is the situation in which

³It should be mentioned that some feel the referendum requirement of many states on tax issues is a factor impairing legislative fiscal control. Vide Karl A. Bosworth, "Law Making in State Governments," The Forty-eight States: Their Tasks as Policy Makers and Administrators, Final Report of the Eighth American Assembly, Graduate School of Business, Columbia University (New York: Columbia University, [1955]), pp. 91-92.

⁴Constitution of the State of Montana, Article XII, Section 9.

legislatures are permitted to pass increases in taxes or new ones on their own initiative. Law-making on the state level "is a part-time business that draws legislators and lobbyists from all over the state to the statehouse and nearby hotels, usually for four or five months in odd-numbered years." In any event, time is insufficient to dwell adequately on all matters of state. In addition legislators are elected to represent their constituencies; if voters are disinterested in most problems of state government, they are probably least apathetic in matters pertaining to taxation. In the face of a growing tax burden, voters are becoming increasingly adverse to any additional taxation. It is difficult to blame a legislator for earmarking necessary tax revenues in such cases to a source compatible with the value judgments of those electing him. After all, "although not nearly all who want to go to the legislature get there, probably nearly all who get there want to." There are almost always special interest groups, often quite powerful, to cajol, threaten or otherwise convince a legislator that


7A recent millage issue election in Missoula County and statewide abolishment by petition of Montana liquor tax increases help bear this out.

8Bosworth, op. cit., p. 99.
they need additional and assured income. The arguments these groups can forward, not to mention the votes they may control, are frequently impressive enough to secure their objectives. The importance of these groups in state politics should not be underestimated. Many feel that state legislatures, in their short and hectic sessions, can do little more than approve or reject the conflicting interests of the pressure groups confronting them.

II. THE BENEFIT PRINCIPLE

Probably the best argument for earmarking revenues revolves around the idea that people should be required to pay for services they receive. The point is most often made in reference to earmarking revenues from the gasoline tax, but it is occasionally employed in other fiscal areas as well, such as fish and wildlife management.

Judging by one of Adam Smith's canons of taxation, that of equitability, it would appear that "from the point of view of the desirability of people paying for the services they use, it is sensible to spend the income from the

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9Mansfield, _loc. cit._


11Bosworth, _op. cit._, pp. 92-105.
gasoline taxes, for example, on maintaining highways."\textsuperscript{12} In other words those who use the highways should be the ones responsible for maintaining them. We cannot in good conscience, goes the argument, assess people for a service from which they never realize benefit. Also, many feel that it is undemocratic for some members of the population to receive a benefit with no obligation to pay taxes.\textsuperscript{13}

Another important factor arising from employment of the benefit principle might well be the interest that is generated in participants. It is quite possible that citizens paying the tax in question will develop at least some sense of responsibility toward the program involved. Through earmarking, then, at least a portion of a state's populace may have more feeling of participation in various projects than is the case when specific revenues contribute to the general fund.\textsuperscript{14}

Finally, there are many who feel that the increased revenue demands faced by the states cannot be met without taxing, at least to some degree, the lower income groups, who may not normally pay taxes.\textsuperscript{15} If lower income classes are the primary recipients of a service and the tax financ-


\textsuperscript{14} \textit{Ibid.}, p. 157

\textsuperscript{15} \textit{Ibid.}, p. 158.

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ing this service is earmarked, under the benefit principle, some tax revenues can be demanded from this lower income source.

III. CERTAINTY OF YIELD

States may, by earmarking certain funds, guarantee at least some income for specified projects. As previously mentioned, this factor may have played a part in the near nationwide earmarking of gasoline taxes. In other fields, such as education, the practice may be considered important to insure revenues despite possible general fund shortages.

One of the most vital requirements for certainty of tax yield for a specific purpose centers on debt retirement. States often require their local government units to assess sufficient taxes to cover all debt charges. Tax revenues are often earmarked to retire debts on the state level as well. In Montana, as in several other states, the retirement of veterans' bonus bonds serves as an example.

Assurance of a tax yield from a specific and relatively certain source aids in debt expansion. Not only are bonds more easily sold when such assurance prevails, but the interest an issuing agency must pay may well be reduced. If the revenue source allocated is very certain, even a financially embarrassed government can borrow additional funds.
Another point in favor of earmarking might be that a specifically assigned fund offers comparative safety in connection with political distribution. That is, there is not so strong a tendency on the part of the politically ambitious to give distorted preference to pressure group demands when allocating general funds if such groups already receive some earmarked funds. It is possible, then, that earmarking lessens inefficiency or carelessness caused by the all too common practice of "log-rolling."

CHAPTER III

THE CASE AGAINST EARMARKING

Several arguments have been presented favoring the fiscal device of earmarking. Whereas some of these are, at least to some extent, economically valid, some are not. It will be the purpose of this chapter to indicate any invalidities in these arguments and present additional points in opposition to earmarking of public revenues.

A majority of modern state-and-local tax experts have censured revenue assignment on many grounds. One member of the Montana State Board of Equalization stated, "Earmarking is nothing more than a slick device designed to get around legislative control."¹ The American Assembly, an organization of the Graduate School of Business at Columbia University, affirmed, "Earmarking, which has its defenders, has gone much too far and the process should be reversed."² As early as 1932, in reference to earmarking in the State of Ohio, it was reported that "it is the special fund . . .

¹Statement made during personal interview with members of the Montana State Board of Equalization.


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which gives state officers their chief concern in managing the State's affairs."\(^3\)

I. POLITICAL CONSIDERATIONS

Most of the political considerations presented in Chapter II are not arguments in favor of the economic efficacy of earmarking. Rather, they are factors indicating that the device is likely to be used for good or ill for some time to come. It is doubtful if legislatures will be sufficiently free of the effects of pressure groups in the foreseeable future to be able to abolish all of the special funds now existent.

Although it cannot be denied that states face an acute need for additional revenue, it can be argued that many states have not utilized several fruitful tax sources open to them.\(^4\) "It is a myth that the states cannot raise more taxes, however traditional their reluctance."\(^5\) For the most part, they need only look to their counterparts throughout the nation to discover elsewhere currently productive


\(^5\)Ibid., p. 24.
tax measures not yet used at home. New tax sources need not be earmarked in order to be tapped, for, with but few exceptions, the examining states may also note that earmarking of the tax source in question is not universal among utilizing states. It would appear that at least some states have been able to obtain acceptance of certain taxes without assigning revenues to especially appealing purposes. The argument, then, that some tax sources necessitate earmarking in order to make them publicly acceptable is not consistently valid.

In addition, if state fiscal bodies strived for more newspaper coverage, and set up or broadened programs of educating and informing the public, it is likely that the importance of earmarking to acceptance of increased tax burdens would radically decrease.

II. LACK OF ADMINISTRATIVE DISCRETION

The problem of legislative discretion goes hand-in-hand with the political factors surrounding earmarking. Special fund expenditures are not generally controlled by legislative appropriation; budgetary control is usually confined to expenditures from the state's general fund.\(^6\) There

\(^{6}\)It should be admitted that because states are not alike, circumstances may vary widely. To gain general acceptance of a tax, some states, under some circumstances, may find earmarking expedient.

is in Montana little or no control, by means of appropriations from the general fund, over nearly 60 percent of state revenues.

The earmarking of revenues is a substantial hindrance to the adequacy of the budget process. . . . The existence of earmarked funds, which are very pervasive in many states, is a serious bar to a comprehensive budget. 8

The legislature, which is supposed to constitute the state policy-making body, loses much of its basic meaning when earmarking is employed. The responsibility of the legislature is to

. . . determine what activities are to be undertaken, and to what extent they are to be conducted. . . . The segregation of special revenues to special purposes is an evasion of this legislative responsibility. 9

The House and Senate, through earmarking, lose the ability to appropriate to an activity in accordance with its importance in relation to all other activities. The legislative body is, in a large part, deprived of "a periodic appraisal and examination of the activities being carried on and the relation of the costs of these activities to revenues available." 10


10 Ibid.
III. INFLEXIBILITY

A flexible budget is one which may be altered to fit changing fiscal situations. If, for example, a contingency forces high expenditures for one activity, funds can be readily obtained that would normally have gone to another less hard-pressed activity. In this respect, not only the state legislature but the governor, who normally is responsible for submitting a proposed budget to the legislature, feels the effects of assigned revenues. His discretion, as well as that of the legislature, is impaired.

A rather constant battle to get and keep revenues in a general fund is commonly necessary to free both the governors and the legislatures for the making of revised decisions on spending and tax policy.\(^\text{11}\)

It seems unwise, putting it mildly, to glut one state program while starving another. As Professor Cline put it, over twenty years ago, in reference to earmarking in New Jersey, "... the situation is comparable to that of a man who carries money for his lunch, cigarettes, shows, etc., in separate pockets and goes hungry because his lunch money pocket happens to be empty although the others contain cash."\(^\text{12}\)


While the general fund in Montana ran temporarily short of funds in 1958, more than $6 million languished in the Korean and World War II veterans' bonus funds.

IV. DEFICITS AND SURPLUSES

Most earmarked funds cannot be used for other purposes. Implementing special funds creates the possibility of surpluses and deficits. One fund may carry a large unused surplus while the general fund and other assigned funds struggle along on inadequate budgets. An agency receiving more income from an earmarked tax than it anticipated may either provide more elaborate service than was the legislative intent when the tax was earmarked, or build up money reserves, or both. The earmarked fund instigated in Montana to retire bonds financing the World War II veterans' bonuses serves as an example. This income, derived from a 2 cent per package tax on cigarettes, has come in so rapidly that as of January, 1958, more than $4 million lay idle in the fund.\(^{13}\) The fund is so set up that the money cannot be used for other purposes. The bonds issued are of such nature that they cannot be retired at an earlier date. The money, then, regardless of budgetary difficulties in other areas, must lie idle until the bonds can be retired, and

\(^{13}\)Information in this section obtained in personal interviews with members of the Montana State Board of Equalization.
meanwhile fund receipts continue to pour in.

The building up of surpluses in a fund, when the money cannot be used for other purposes, could amount to forced public savings. It may constitute a slightly depressing force in the economy.

In Montana, tax receipts are placed in commercial banks, approved by a Depository Board, as they are received. These deposits need not be secured up to the amount of deposit insurance held by the bank, which is usually $10,000. Any deposits over this amount must be guaranteed by some type of securities held by the bank which meet with the approval of the Depository Board, such as federal or state bonds or Federal Reserve Bank securities. As a general rule, commercial banks holding tax receipts deposit with the state, on a yearly average, more than the required securities, in order to be prepared for sudden influxes of tax receipts on collection dates. Recipient banks are required to pay interest on deposits, currently 1 percent per annum, and may use the funds at their discretion. In Montana's case, deposits are confined to commercial banks within the state. Funds are drawn upon by the State Treasurer as the need arises.

It is apparent that the state banking system as a whole does not gain or lose deposits. A check is written or

\[1\text{Revised Codes of Montana, 1947, 79-301.}\]
cash is withdrawn from a bank to pay the tax; the receiving agency deposits the amount back in a bank. Banks, as a general rule, prefer many small depositors to a few large depositors. This is true because the business of a commercial bank centers around loaning operations. Loans must be backed by reserves. If a bank operates with a small number of large depositors, one complete withdrawal may reduce a reserve position, and therefore a loaning capacity, considerably. On the other hand, complete withdrawal by a few of many small depositors will not greatly affect a bank's position. Not only is the state a large depositor, but banks may hesitate to count on state deposits since they will normally be withdrawn by the end of a fiscal year. Though state withdrawals are usually returned to the banking system by smaller depositors, unused funds, such as those for the World War II and Korean veterans' bonuses, may, to a considerable degree, constitute money effectively taken out of circulation.

It may be said that the slight depressing effect of fund surpluses during a period of inflation could prove beneficial. For cyclical control, the device employed should be subject to reversal as economic factors dictate, and disuse when not required. There is no such control with fund

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15 The money may, rarely, come from out-of-state banks, but the amount would usually be insignificant.
surpluses.

V. LACK OF CONTROL

Agencies receiving earmarked revenues achieve some degree of independence from legislative control. By virtue of gaining an income independent of legislative action they gain powers not experienced by those operating on appropriated funds. The administrative and financial efficiency, as well as utility, of the program receiving earmarked revenues is not subject to close periodic scrutiny. Earmarking, then, does not necessarily represent an attempt to improve the fiscal program involved, but is perhaps an attempt to "protect and isolate the beneficiaries of specific governmental programs."\textsuperscript{16} These programs fall beyond the scope of review by a budget office.\textsuperscript{17} There is little, if any, reason why this power should be taken from the legislative and executive branches and given to specific activities. Even if the program in question is subject to periodic review, statutory revision is "not likely to emerge from the budgetary process"\textsuperscript{18} once a tax is earmarked.

If prudent fiscal policy implies the ability of states to adjust their tax structures and expenditures to

\textsuperscript{17}Ibid.
\textsuperscript{18}Ibid.
needs, which would certainly seem to be the case, the logical inference is that earmarking of public revenues should be abolished. By placing all revenues in the general fund, complete budgetary flexibility would be more nearly approached, and each state activity would receive periodic executive and legislative consideration. Put another way, ...

... from the point of view of sound financial administration and of the effective functioning of democratic government, earmarking cannot be too severely criticized. The burden of proof should always be in favor of passing all revenues through the general fund and placing them under control of the legislature.\(^9\)

The power of the purse has been for centuries a major instrument of popular control of executive and administrative activities. The public's voting to earmark funds displays a mistrust of the legislators they elect to run their government. Earmarking seriously impairs legislative control and constitutes a substantial hindrance to the budget process.\(^20\) Of course, some earmarked tax sources do not bring in sufficient revenues to completely finance a given program. In such cases, i.e., education in Montana, some of the operating revenue comes from the general fund; there is a degree of legislative control over the activity in question. The property tax has, historically, been the primary source for local school revenues, but because of the inflex-

\(^{19}\)Brookings Institution, loc. cit.

\(^{20}\)Willbern, loc. cit.
ability of yield from this source, local units become hard-pressed in periods of rising prices. Property tax receipts remain relatively stable because, generally speaking and most probably in Montana, property cannot politically bear a tax burden heavier than that currently imposed. Property taxation in this state has risen 163 percent in the past ten years, while property value has increased only 71%. In this and similar cases, additional monies are appropriated from the general fund. There is no defensible reason why all tax sources should not go to the general fund, from which the entire activity could then be financed.

VI. THE BENEFIT PRINCIPLE

A close relationship seems to exist between those who pay motor fuel taxes and those who use highways. The more we drive on the public highways, the more fuel we use and, consequently, the more we pay in taxes. When the fuel tax is dedicated to highway maintenance and construction, it becomes a sort of fee for the privilege of using the roads.

A similar relationship seems to prevail in the

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area of fish and wildlife management. If revenues from hunting and fishing licenses are earmarked for the State Fish and Game Commission, those who purchase the privilege of hunting or fishing within the state are direct beneficiaries of the fees they pay.

In both fields, the tax appears to be levied upon those who benefit from the service. Further, it appears that the outlay in each field creates measurable benefits for those paying the tax. The driver has an improved and expanded highway system; the purchaser of a fishing license reaps stocked streams and lakes and policing of his sport.

Although earmarking of highway-user, wildlife and some other tax receipts is generally considered justifiable under the benefit principle, it is not above criticism. Those using the highways, for example, may ask if they are the sole beneficiaries of an improved and more widespread system of roads. From the point of view of national defense, all citizens benefit whether they personally use the highways or not. Likewise, all benefit by virtue of a more closely knit economy. The operators of various businesses

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receiving material by truck also profit. Therefore, if the benefit principle were strictly adhered to, everyone should be responsible, at least to some extent, for paying highway taxes.

A similar, though probably less convincing, argument could be made for wildlife management. To some extent, everyone benefits, at least indirectly, from such items as pure streams and increased tourist trade.

The problem here, and it will nearly always be associated with the benefit principle, is to determine who actually profits from a service and to what extent. The solution is debatable in such an apparently clear-cut field as highway-user taxes. It is considerably more obscure, if not indistinguishable, in other areas, such as education. If earmarking is justified by the benefit principle, the justification rests on a basis that is questionable.

Although some needed revenue may be obtained from lower income groups contributing to an earmarked tax, there appears to be little reason why, if these groups are to be

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24 It may be argued that these persons in effect pay highway-user taxes through increased transportation charges. It is doubtful, however, that the entire incidence of the tax is shifted forward in the short run. It is probably, but not necessarily, true that the motor fuel dealer shifts the entire excise tax to the trucker, but transportation rates are affected by numerous factors of which that of costs is but one. Other factors involved in the setting of transportation rates would include demand, regulation, and competition.
taxed anyway, the receipts from this source should not go to the general fund. Further, taxing lower income groups on a benefit-received basis would tend to make the tax regressive. That is, lower income groups may contribute larger percentages of their incomes than higher income groups. Once again, the problem of who actually benefits and to what degree arises. If, for example, a tax source is earmarked for a slum clearance project, not only those living in the slum area, but everyone in the community, benefit. If, under the benefit principle, those inhabiting slum areas are forced to pay a major portion of the program's cost, a greater percentage of their income contributes to taxes than of the income of those higher income groups who also benefit and who most often foster this type of project.

There is no reason why taxes considered by some units to be benefit levies may not appear elsewhere, at different times, or for that matter simultaneously, based on a criterion other than benefit. 

Though the benefit principle can be criticized, it

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25 There is question as to just what constitutes a regressive tax. Generally speaking, and in this context, a tax is regressive if it takes a larger percentage of a lower income than it does of a higher income. A progressive tax is the opposite of regressive, and a proportional tax claims the same percentage of all incomes.

has many defenders. Many taxation experts use it to justify earmarking. It is not the purpose of this thesis to completely discredit the theory, but to indicate that, as far as revenue dedication is concerned, there is room for disagreement. In this regard, Groves states:

As to conflicting viewpoints among public-finance scholars, one must begin by conceding that most of the field is controversial. There is very little in taxation to hand out as "accepted doctrine." Critics differ in their preference for one tax or another because they have different values, different philosophies of life, different kinds of worlds in which they would chose to live. Thus a public-finance writer finds himself in the unenviable position where most of what he might say could be contradicted by someone at least as competent and well informed as himself.27

In relation to earmarking, the benefit principle has been carried beyond rational bounds. Recent earmarking practices are often accomplished when the "relation between the recipients of a governmental service and those who pay the tax earmarked to finance that service is nebulous at best."28 Even if one concedes that cases exist where persons receiving government services can be made to pay for them, such cases are limited and do not of themselves justify specific revenue dedications.

27 Groves, op. cit.
VII. ABILITY-TO-PAY

Another broad social philosophy of taxation is the ability-to-pay theory. As the phrase implies, the theory states that taxes should be levied in accordance with individual capacity to bear the burden. There does not appear to be any justification for earmarking ability-to-pay levies. An individual's ability to bear a tax burden in no way relates to state expenditures of funds received. The earmarking, prior to 1941, of liquor taxes in Montana to welfare was based on the tax yield. Those who indulged in alcoholic beverages had no theoretical justification for assuming that their tax contributions should have been measured by relief payments to them or to the general community.

VIII. CERTAINTY OF YIELD

It should not be necessary with the modern budgetary methods of an advanced economy to dedicate a tax source in order to expand debt. However convenient the device, it is doubtful if earmarking is necessary either to obtain credit or to reduce interest payments. Although it may prove useful for an underdeveloped economy to assign tax revenues, few would contend that our current economic situation is such that tax revenues must be dedicated in order to borrow.

29Burkhead, op. cit., p. 469.
The extent and cost of state borrowing depends on the credit of the state in question. State credit is not improved by earmarking revenues.

IX. EASE OF HANDLING

The abolishment of special funds would greatly simplify the accounting and reporting work now necessary in state fiscal management. If all monies went to the general fund, one set of books would suffice. As the situation now stands, each of several special accounts has "... as it were, its own accounting personality, its own receipts and disbursements, its own resources and obligations."30

Fiscal operations in Montana have become highly complex. The state currently receives income from more than 160 sources, of which approximately one out of five is earmarked. Expenditures involve around 250 different agencies.31 Each fund must be handled as a separate accounting proposition, involving considerable expense, time and inconvenience, for which the public pays.

X. INEQUITY

State expenditures fall into three general types:

31Information obtained in personal interviews with members of the Montana State Board of Equalization.
(1) those which are traceable (earmarked) but not intended as subsidies, (2) those which are traceable and intended as subsidies, and (3) those which are not traceable. In the third instance, benefit is virtually impossible to assign. It is difficult to assign in the first two cases. Do all benefit and, if so, do all benefit in proportion to contribution? As has been mentioned, the answer to this question is far from simple.

The assignment of certain specific revenues to some fields is of questionable equitability. For example, only smokers pay veterans' bonuses in Montana. There is no reason to believe that non-smokers should be exempt from this burden. Likewise, the University System fund is supported by an earmarked 6-mill property levy as well as by monies from the general fund. Thus, property owners as a class are singled out to contribute substantially to higher education. Because of the vagaries of property tax assessment and types of property taxed, the contributing group becomes even more unique. In any event, it appears that only certain taxpayers are to a large degree responsible for many of the tax revenues falling into the second classification of expenditures mentioned above.

If all revenues contributed to the general fund,

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civic responsibilities would rest, at least to some extent, on each and every citizen.
Chapter IV

Summary and Conclusions

I. Summary

Points have been presented on both sides of the earmarking question. The benefit principle supplies the best argument in favor of earmarking as a fiscal device. Political ramifications surrounding the problem seem to indicate that, good or bad, the device will prevail.

Budget inflexibility, the diminution of legislative discretion and of control of recipient agencies, and increased administrative financial duties, prove to be strong arguments against earmarking. In addition, the possibility of development of fund surpluses and deficits must be considered.

Opponents of earmarking also have some justification for criticizing revenue dedication from the point of view of the benefit principle and equitability. It can be argued, too, that yield certainty is nearly meaningless in a well-developed economy.

As a general principle, therefore, the validity of the original hypothesis, that earmarking of public revenues is poor fiscal policy, is strongly indicated. Some qualification is required, however. When a situation exists such
that the only way in which a needed revenue can be obtained is to earmark the proceeds of the new or increased tax to a special purpose, revenue dedication may be justified. These cases should prove very rare exceptions. Considering the drawbacks of earmarking, it would not appear unreasonable for state fiscal managers to expend some time and funds in an attempt to interest average citizens enough in fiscal operations to want to learn more about it. It is conceivable, and to be hoped, that an informed citizenry would reduce the influence of special interest groups as well as the likelihood of revenue assignment by action of the voters. The present situation in many states, Montana included, indicates that the unorganized citizenry only infrequently questions the motives of well-organized pressure groups.

Initiated measures committing sizable blocks of state revenues to particular programs... create embarrassing situations for state governments. Increasingly the device seems available not to "the people" but rather to groups with the funds necessary to put over the petition signing.¹

The protest petition abolishing increased liquor taxes in Montana in 1957 is an example of the strength of special interest groups. The Montana Bar Owners' Association was able to obtain sufficient petition signatures to cancel the

increase and force the state to operate for the next two years on considerably less income than the legislature had counted on. We can only speculate on what might have taken place had the tax revenue been dedicated to some appealing purpose such as aid to the blind. The petition might have failed. However, with the present dearth of publicity regarding legislative activities, it is safe to assume that petition signatures would have been very nearly as easy to obtain as they were under the actual circumstances. Perhaps a referendum, with its attendant publicity, requiring consideration of all the voters, would have provided different results. In any event, if earmarking were required to alter the fact that petition signers ultimately canceled the tax, the intent of the levy, i.e. to contribute to the general fund, was still defeated.

It must be admitted that political factors constitute sufficient importance, at least occasionally, to justify assignment of revenues. Whatever can be done to minimize the importance of these factors should be expedited. Clearly, "assigned revenues appear to be the root of . . . abuses, which are clearly incompatible with efficient financial administration."  

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There are but two criteria by which earmarking of public revenues can be justified: political expediency and the benefit principle. Of these, neither is consistently applicable and both are subject to criticism.

The fact that earmarking may be politically expedient has no bearing on factors of fiscal policy. Earmarking constitutes poor fiscal policy whether or not political factors dictate its use.

If credence is given the benefit principle as related to earmarking, other aspects of devoted revenues should be considered. The Council of State Governments points out:

While some state legislatures may find it expedient to earmark certain kinds of funds where there is a direct, clear-cut, intimate relationship between the source of the money and the object of the expenditure, the practice of earmarking is bad in itself because it frequently lends to extravagance and waste. . . .

Extenuating circumstances involved at a particular time and place may seemingly justify dedication of tax revenues. Whether such justification is based on the benefit principle, political factors, or both, if earmarking results, so does poor fiscal practice. The demand-supply relationship, as it were, is not given a chance to function. Taxes may have to be raised to satisfy demanded expenditure for one activity while another has more revenue than demand.

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warrants. Revenue assignment and revenue maldistribution thus go hand-in-hand.

II. CONCLUSIONS

Montana abolished the earmarking of several major tax sources in 1941. These included 50 percent of the liquor license tax, 25 percent of the personal income tax, \(^4\) 50 percent of the tax receipts from public utilities, 50 percent of the metal mines tax, and 50 percent of the inheritance tax. Had these tax sources been earmarked in 1957, approximately \(\$4\frac{1}{2}\) million would have been withheld from the general fund. In view of the fact that nearly 60 percent of the state's total tax revenues were earmarked in 1957, it would appear that the fiscal situation could be improved by a repetition of the 1941 action. Of the prevailing major dedicated expenditures in the State of Montana, \(^5\) those for highways and the State University System are the only two with visible justification.

**Limited Justification**

Earmarking of highway-user taxes to the state highway system may be justified by the benefit principle. As has

\(^4\)The 1937 law would have earmarked 50 percent of income tax receipts to education. The 1941 law earmarked only 25 percent to that activity.

\(^5\)See Table III, page 21.
been observed, such justification is somewhat nebulous.

Earmarking the University System millage fund may be justified by virtue of the nature of the prevailing law and voter attitude, that is, by political expediency. Under Montana law, the state-levied property tax cannot exceed 2 mills without public approval. Indicated voter attitude toward tax increases does not predict a disposition to vote a mill levy on property to be contributed to the general fund. Recent experiences hint that the 6-mill University System levy may have difficulty obtaining voter renewal this November even though dedicated to the currently exciting issue of higher education. However, a recent survey conducted by the Montana Governor's Committee on Education disclosed that Montanans desire to have more factual information concerning problems involved in higher education. Dissemination of such facts would probably rally sufficient voter support to pass the measure. By mid-July, three important groups, the Governor's Committee on Education, the Montana AFL-CIO, and the Republican State Platform Convention, had expressed approval of the levy. An important adversary of the issue is Chairman J. F. Reid of the State Board of Equalization. The opposition of this department rests on two bases: first, opposition to earmarking of revenues in any form and thus, in principle, to the University

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System levy; second, the opinion that a sales tax is necessary in Montana in order to acquire needed revenues and relieve property owners. The Chairman feels that if the 6-mill University System levy fails at the polls, the legislature will be forced to instigate a sales tax. The Board has expressed vehement opposition to dedicating revenues from a possible sales tax, either to education, or to any other specific activity.

**No Justification**

There is no justification for earmarking the cigarette or individual and corporation income taxes.

The cigarette tax is primarily an ability-to-pay levy. The benefit principle does not apply because the ability-to-pay theory relates only to yield. There is no relationship to expenditures. The tax must by law be partially earmarked for veterans' bonuses until bonds are retired. From that time on, the other criterion for revenue dedication, i.e. political factors, should not prove of sufficient importance to require that this income be devoted to any other than the general fund.

Personal and corporation income taxes also are basically ability-to-pay levies. Again, justification for ear-

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7News item in *The Daily Missoulian*, May 1, 1958.
8Snudleson, *op. cit.*, pp. 194-95.
marking these revenues is not forthcoming on the benefit principle. There is little, if any, indication that the political climate demands assignment of these revenues. The legislature should devote all proceeds to the general fund.

III. RECOMMENDATIONS

As in all states, fiscal operations in Montana continue to become increasingly involved. Conflicts among interest groups, political units, and individuals, along with a generally expanding economic system, have all contributed to the complexity of taxation problems. The need for increased revenues must be faced; many feel some relief must be found for property owners. It would seem, then, that new tax sources must be tapped. In this regard, two sales tax bills were presented at the 1957 legislature. Both were killed by Ways and Means Committees. The first of these would have established a 2 percent sales tax with proceeds to go to the general fund. The second, also for 2 percent, would have earmarked the proceeds for education. It is recommended that, if future legislators pass a sales or any other new tax, revenues contribute to the general, rather than an earmarked, fund.


10Information obtained in personal interview with members of the Montana State Board of Equalization.
The writer also recommends specifically that those funds currently earmarked, with the possible exception of highway-user and University System levies, be redirected by legislative act to the general fund.
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